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FINANCIAL REGULATION 4.1, PARAGRAPHS (D) AND (E)

Report of the External Auditor with regard to his views and comments on proposed paragraphs (d) and (e) of financial regulation 4.1 of the United Nations Industrial Development Organization*

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LETTER OF TRANSMITTAL

11 May 1992

Dear Mr. Siazon,

In response to resolution GC.4/Res.23, paragraph 2, adopted by the General Conference on 22 November 1991, I have the honour to transmit herewith for submission to the Chairperson of the Programme and Budget Committee a report with regard to my views and comments on the proposed paragraphs (d) and (e) of UNIDO financial regulation 4.1.

Yours sincerely,

(Signed)

Jeroom L.E. VAN de VELDE
Senior President of the Court of Audit,
Belgium
External Auditor

Introduction

1. The present report is submitted in response to resolution GC.4/Res.23 on financial regulations and staff regulations, adopted by the General Conference of the United Nations Industrial Development Organization (UNIDO) on 22 November 1991.

2. In resolution GC.4/Res.23, paragraph 2, the General Conference has requested the External Auditor to submit a report to the Programme and Budget Committee at its eighth session on his views and comments on the proposed paragraphs (d) and (e) of financial regulation 4.1. This request is in conformity with UNIDO financial regulation 11.6 which stipulates that the Conference, the Board or the Programme and Budget Committee may request the External Auditor to perform certain specific examinations and to issue separate reports on the results.

* The present document has not been edited.

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3. The scope of our audit exercise included: (a) a formal, technical analysis of the text of the proposed paragraphs (d) and (e) of financial regulation 4.1; and (b) a summary review of the validity and appropriateness, in the present circumstances, of the operational budget flexibility arrangement introduced with the proposed financial regulation 4.1 (d) and (e).

4. In line with established audit practice the findings and conclusions of the audit exercise as well as the views and comments expressed in the present report have been discussed extensively by the audit team with senior officials of the Organization and their comments and observations have been taken into account where appropriate.

I. SUMMARY OF FINDINGS AND CONCLUSIONS

5. We observed that proposed financial regulation 4.1 (d) conforms insufficiently to the Secretariat's (ex post facto) accountability and reporting requirements to the policy-making organs.

6. The Administration agreed with our observation that the accountability and reporting requirements in this case should necessarily include full information particulars on the calculation of revised operational budget income estimates.

7. Our review further indicated that proposed financial regulation 4.1 (d) takes into account other operational budget expenditure flexibility parameters than the higher than planned delivery retained by the team of independent experts on the programmes and budgets of UNIDO. The Administration, however, referred to the new developments in the United Nations Development Programme (UNDP) successor arrangements for support costs and stressed that delivery will be increasingly delinked from support cost reimbursements so that financial regulation 4.1 (d) proposed by the Director-General is more realistic and appropriate to the future shape of support cost reimbursements than the initial proposal of the team of independent experts.

8. We expressed the view and the Administration agreed that mandatory reserves should at any rate be excluded from an operational budget expenditure flexibility formula.

9. We learned that it is impossible for the Secretariat to introduce at this juncture formal rules for the use of operational budget resources as recommended by the team of independent experts because, given the new developments in the UNDP successor arrangements, the implication for UNIDO has changed in an as yet unclear manner and extent. The Administration assured nevertheless that the Director-General has clearly stipulated in his programme and budget guidance letter to UNIDO managers that operational budget resources will be directed to programmes supporting technical cooperation activities.

10. As regards the (regular budget) subsidy cost control, review and reporting mechanism, recommended by the team of independent experts, it would seem that such a mechanism cannot be established at this point, given again the drastic changes in UNDP successor arrangements for support costs. The Administration argued convincingly that, in the circumstances, a post facto reporting based on the methodology and the results of the UNDP cost identification and measurement study will be an appropriate monitoring basis.

11. In the ultimate analysis and given in particular the new developments in the UNDP successor arrangements for support costs and the resulting uncertainties of the future as regards the operational budget financial resources, we reached the conclusion that:

(a) The report of the team of independent experts, their recommendations and the proposed revision of financial regulations are no longer valid or up to date;

(b) Therefore, the actual implementation of any new operational budget expenditure flexibility system should best be postponed until the evolving new situation can be assessed more accurately in all aspects; and

(c) The discussion of proposed regulation 4.1 (d) and (e) in its present or altered form must also await a point where UNIDO is more clear about how the new UNDP arrangements will impact upon its operational budget.

12. In our view, sufficient operational budget operation flexibility is meanwhile provided to the Secretariat under the terms of the prevailing UNIDO financial regulation 4.1 (b) and (c).

II. ANALYSIS OF THE TEXT OF PROPOSED PARAGRAPHS (D) AND (E) OF FINANCIAL REGULATION 4.1

Executive accountability

13. We observed that proposed financial regulation 4.1 (d), in stipulating that "the Director-General is authorized to incur obligations and to make payments in excess of the limitations set by the Conference for the operational budget", conforms insufficiently to the general legislative principle of mandatory (ex post facto) reporting to the policy-making organs on all executive decisions affecting the programme and budgets previously approved by the policy-making organs (cf. UNIDO regular budget financial regulation 4.3 (c)).

14. The Administration stated in this regard that it should be clear to Member States that any operational budget expenditure flexibility ruling would not in any way abrogate the Organization's accountability and reporting requirements to the policy-making organs. The Administration agreed also with our observation that the Secretariat's accountability and reporting requirements in this case necessarily include the provision of full particulars on the calculation of the revised operational budget income estimates.

Formal delimitation of executive operational budget expenditure flexibility

15. We found that while the team of independent experts recommended the adoption of an operational budget flexibility rule based solely on "a higher than planned delivery" (cf. document PBC.5/16 of 24 February 1989, para. 124), the proposed financial regulation 4.1 (d), in line with the relevant proposals of the Director-General (cf. document PBC.6/10, para. 3), provides for operational budget expenditure flexibility on the basis of "the total estimated income from the

current fiscal period and the unutilized balance of the operational budget from the previous fiscal periods". Proposed financial regulation 4.1 (d) thus takes into account other parameters than a higher than planned delivery, such as additional income from reimbursement of support costs at a rate higher than projected by the UNDP, additional income from investments and unused income from previous bienniums (reserves).

16. In this regard, we inquired about the reasons for the major shift in the nature and the (financial) scope (cf. budgetary and financial data in annexes I-IV to the present document) of the operational budget flexibility parameters used in proposed financial regulation 4.1 (d) compared with the proposal of the team of independent experts. We pointed out also that, in the circumstances:

(a) The validity and appropriateness of the retention of an unchanged 10 per cent flexibility threshold remain to be demonstrated; and

(b) A formal limitation on the operational budget expenditure flexibility of the Secretariat (or a flexibility ceiling) might also be indicated.

17. With regard to our note on "higher than planned delivery" the Administration stated that it is worth recalling that, given the new developments in the UNDP successor arrangements for support costs, delivery will be increasingly delinked from support cost reimbursements. Therefore, proposed financial regulation 4.1 (d) quite correctly emphasizes the fact that the estimated income plus unutilized balances (i.e., estimated cash availability for the operational budget) constitute the operative basis for incurring obligations and, consequently, is more realistic and appropriate to the future shape of support cost reimbursements than the proposal made initially by the team of independent experts (cf. also para. 23 below).

18. The Administration argued further that the notion of a ceiling should be discouraged on two counts: (a) first, in the future, the Organization will be reimbursed not on a flat rate basis but in accordance with an agreed formula for specific services. Therefore, it is likely that the so-called regular budget subsidy will not be as great as initially estimated by the team of independent experts. At present, it is impossible to estimate the mix of the services that the Organization will be required to provide through its technical cooperation activities; and (b) secondly, in the unlikely event that there is a surge in the demand for its services, the Organization should not find itself in the conventional position of being hamstrung for want of resources or authority to incur expenditures and earn the resulting income.

Budgetary use of unutilized balances of the operational budget from previous fiscal periods

19. Our examination indicated that proposed financial regulation 4.1 (d) is not sufficiently clear with regard to the amount of "the unutilized balance of the operational budget from the previous fiscal periods" that may be obligated under the operational budget flexibility arrangement. In our view, it should be clear that this unutilized balance cannot include any part of the mandatory reserves held under the operational budget of the Organization (cf. annex IV to the present document). In this respect we draw attention to PBC conclusion 1991/6, paragraph (f), (i) which requested the Director-General "To submit proposals to the Industrial Development Board for the introduction of rules for the use of operational budget reserves as contained in document PBC.7/2, paragraph 10".

20. The Administration agreed, in general, that any mandatory reserve (imposed, for instance, by the policy-making organs of UNIDO) should indeed be excluded from an operational budget expenditure flexibility formula.

III. SUMMARY EXAMINATION OF THE VALIDITY AND APPROPRIATENESS OF PROPOSED PARAGRAPHS (D) AND (E) OF FINANCIAL REGULATION 4.1

21. In their report on the programmes and budgets of UNIDO (cf. document PBC.5/16 of 24 February 1989) the team of independent experts recommended the implementation by the Secretariat of a set of budgetary management and control measures.

22. In our view, several of these measures are closely connected with the operational budget expenditure flexibility system introduced with the proposed financial regulation 4.1 (d) and (e) and their implementation prior to or concurrent with the introduction of the operational budget flexibility system seems therefore indicated. Of particular interest in our view are:

(a) The required recommendation by the Director-General on the size and composition of the regular budget support to the operational budget (to be included in future programme and budget proposals) and, in order to strengthen the control of the relationship between the operational and regular budgets, the recommended specific regular budget subsidy (or contribution) cost control, review and reporting mechanism; and

(b) The introduction of rules for the use of operational budget resources (cf. also PBC conclusion 1989/4).

23. In reply to our queries on the subject the Administration pointed out in general that the conclusions drawn by the team of independent experts need to be carefully reviewed in the light of the UNDP successor arrangements for support costs. The 13 per cent regime is being replaced by a composite set of reimbursements which will be derived from: (a) proforma work month costs charged to UNDP for studies undertaken for technical support services at the programme level (TSS-1) type of activities; (b) proforma work month costs charged to UNDP for technical support services provided at the project level (TSS-2); (c) different rates of reimbursement for administrative and operational support to projects under the administrative and operational services (AOS) facility of UNDP; (d) work-months of support provided to projects but charged to project budgets; and (e) a flat rate of 13 per cent will continue to be charged to donors for "transitional" UNDP projects, Industrial Development Fund and trust fund projects. According to the Administration, for the first four categories it may very well be that the

marginal costs of providing services will be met through the rates of reimbursement already established while in the last category, the prevalent cost-sharing formula would apply. In the Administration's view, the net effect on the operational budget depends entirely on the mix of services and projects and the organizational efficiency in providing the various categories of services and projects; it is, however, impossible to estimate at this stage the mix of services and projects.

24. Taking into account the Administration's general clarifications, we found that, strictly speaking, formal rules have not been introduced by the Secretariat for the use of operational budget resources. Nevertheless, it has been clearly stipulated in the Director-General's programme guidance letter for the 1992-1993 as well as 1994-1995 bienniums, that operational budget resources will be devoted to those components of the Organization that support technical cooperation activities and the Administration has assured us that this programming directive is followed in the budgetary allocation process. Moreover, the successor arrangements may apparently very well change the nature of services provided by the Organization and, furthermore, the nature of certain components of the successor arrangements (TSS-1) will involve staff from all substantive units of the Organization, also those that were not involved so far.

25. The Administration argued, therefore, that the independent experts' recommendation calling for operational budget operation rules is valid, but that the implication for UNIDO has changed in an as yet unclear manner and extent so that it is impossible to introduce the recommended formal rules at this juncture.

26. As regards the (regular budget) subsidy cost control, review and reporting mechanism it would seem that such a mechanism cannot be established at this point given again the drastic changes outlined above. It is, however, pertinent to note in this context that:

(a) The UNDP cost identification and measurement study now provides refined estimates of total costs of providing individual services under TSS-1, TSS-2 and AOS categories. The results of this study, which will be updated biennially, will be provided to the policy-making organs who can not only get a view of UNIDO costs, but also those of other major executing agencies. The cost sharing in providing each service can be established by quantifying the total revenue from each service and deducting the total cost of providing that service; and

(b) UNIDO will use the UNDP cost measurement study to update the regular budget cost-sharing estimates (cf. para. 113 of the 1992-1993 programme and budgets, GC.4/42).

27. The Administration argued that, in the circumstances, a post facto reporting based on the methodology and the results of the UNDP cost identification and measurement study would be more appropriate as a basis for monitoring.

28. As to the cost control issue, we refer also to our comments on the subject of statutory budgetary control by the policy-making organs in the external audit report on the accounts of UNIDO for the fiscal period 1990-1991 ended 31 December 1991.

IV. CONCLUDING AUDIT COMMENTS

29. The proposed new paragraphs (d) and (e) of UNIDO financial regulation 4.1 are based in considerable measure on the closely interrelated set of conclusions and recommendations formulated in 1989 by the team of independent experts on the programmes and budgets of UNIDO.

30. During our audit, the Administration stressed repeatedly that the validity of several of the conclusions drawn by the team of independent experts on the subject of operational budget operation has become questionable at present given the new developments in the UNDP successor arrangements for support costs and the resulting uncertainties of the future as regards the operational budget financial resources; it follows, in our view, that the validity and appropriateness of the operational budget expenditure flexibility arrangement proposed by the team of independent experts are necessarily just as questionable in the present circumstances.

31. For the same reasons, and especially taking into account the uncertainties of the future, the validity and the possible (financial) implications of the modifications introduced by the Director-General in the operational budget flexibility proposal of the independent experts cannot yet be evaluated by us.

32. In the circumstances, the obvious conclusion follows that:

(a) The actual implementation of any new operational budget expenditure flexibility system should best be postponed until the evolving new situation in respect of UNDP successor arrangements can be assessed more accurately in all its aspects; and

(b) The Secretariat should then propose to the policy-making organs of the Organization, if deemed necessary, a new coherent set of financial regulations (and rules) for the budgetary and financial management and control of its operational budget.

33. In our view, sufficient operational budget operation flexibility is meanwhile provided to the Secretariat under the terms of prevailing financial regulation 4.1 (b) and (c).

Acknowledgement

I wish to record my appreciation for the assistance extended to the audit team by the Director-General and his staff at the time of the examination and the preparation of the report.

(Signed)

Jeroom L.E. VAN de VELDE
Senior President of the Court of Audit,
Belgium
External Auditor

Brussels, 11 May 1992

Annex I

OPERATIONAL BUDGET EXPENDITURE ESTIMATES BY OBJECT OF EXPENDITURE, 1986 - 1993
(In thousands of US dollars)

Objects of expenditure	Biennium 1986 - 1987 (at US$1 = AS 17.70)	1988 - 1989 (at US$ 1 = AS 12.50)	1990 - 1991 (at US$ 1 = AS 12.90)	1992 - 1993 (at US $ 1 = AS 12.90)
				43,868.3
Staff costs	22,687.3	32,285.9	33,356.9	
Established posts	16,712.5	23,871.9	23,995.8	
General temporary assistance	256.6	18.6	19.2	
Overtime and night differential	35.0	25.6	26.5	
Common staff costs	5,683.2	8,097.4	8,251.4	
Representation allowance		1.2	1.8	
Consultants (fees and travel)		271.2	908.9	
Ad hoc expert group meetings			153.3	
Official travel/meetings	421.4	1,215.3	1,581.1	1,798.9
Official travel of staff	421.4	638.3	982.0	
SIDFA/UCD travel		496.0	514.9	
Local travel - SIDFAs/UCDs		81.0	84.2	
Contractual services	0.0	12.6	13.1	36.2
General operating expenses	64.0	245.4	330.7	560.6
Local transportation		27.7	28.7	
Hospitality		6.9	24.9	
Rental and Maintenance of premises	64.0	83.8	128.6	
Communications		127.0	148.5	
Supplies and materials	0.0	7.1	8.2	30.0
Acquisition of furniture and equipment	0.0	41.1	65.3	74.3
Joint computer services/ electronic data-processing non-staff costs	320.0	392.6	367.7	2,797.4
Other expenditures	0.0	0.0	0.0	69.2
TOTAL	23,492.7	34,200.0	35,723.0	49,234.9

Annex II

OPERATIONAL BUDGET EXPENDITURE ESTIMATES BY PROGRAMME, 1986 - 1993 (In thousands of US dollars)

Programmes	Biennium			
	1986 - 1987	1988 - 1989	1990 - 1991	1992 - 1993
Policy-making organs	0.0	0.0	0.0	0.0
Executive direction and management	820.4	468.7	1,116.7	1,365.2
Policy coordination	4,393.9			
Department for Programme and Project Development		10,483.5	10,193.1	
Progamme and project development				14,630.2
Industrial studies and research	1,471.7			
Department for Industrial Promotion, Consultancy and Technology		3,293.3	3,759.8	
Industrial promotion, consultations and technology				4,778.7
Industrial operations	11,936.6			
Department of Industrial Operations		11,108.8	12,195.6	
Industrial operations				17,406.0
Common programmes	-	-	-	0.0
Conference services, public information and external relations	167.0			
Department of External Relations, Public Information, Language and Documentation services		296.5	61.6	
External relations, public information, language and documentation services				253.3
Administration and common services	4,703.1			
Department of Administration		8,549.2	8,396.2	
Administration				12,362.5
TOTAL	23,492.7	34,200.0	35,723.0	*50,795.9

* Reduced to $49,234,900 (GC.4/Res. 27, para. 7, of 22 November 1991)(doc. GC.4/42/Add.1 of 14 November 1991).

Annex III

UNIDO SPECIAL ACCOUNT FOR PROGRAMME SUPPORT COSTS
(OPERATIONAL BUDGET EXPENDITURES)
(In thousands of US dollars, at actual rates)

Objects of expenditure	1986 - 1987	1988 - 1989	1990 - 1991
Staff and other personnel costs	31,534.2	28,886.7	39,603.8
Travel	575.1	1,018.3	1,372.5
Contractual services	0.6	10.3	17.1
Operating expenses	17.3	212.9	402.2
Supplies and materials	-	49.1	52.5
Fellowships, grants, other	14.9	244.5	279.0
TOTAL EXPENDITURE (A)	32,142.1	30,421.8	41,727.1
TOTAL INCOME (B)	27,247.1	34,088.6	40,283.7
EXCESS OF (B) over (A)	(4,895.0)	3,666.8	(1,443.4)

Annex IV

UNIDO SPECIAL ACCOUNT FOR PROGRAMME SUPPORT COSTS (OPERATIONAL BUDGET)

Reserves and fund balances
(In thousands of US dollars)

	31 December 1985	31 December 1987	31 December 1989	31 December 1991
(Mandatory) operating reserve	2,278.4	2,442.1	5,125.7	5,504.2
Unencumbered fund balance	9,977.9	4,919.2	5,902.3	4,225.0
TOTAL	12,256.3	7,361.3	11,028.0	9,729.2